ERIE DIVERSIFIED INDUSTRIES LIMITED

Report to Shareholders

Six month Fiscal Period ended December 31, 1968.

DIRECTORS
Frederick A. Litwin
George Frankl
William Harry Giles
John McCutcheon
Paul Michelin
Bernard Walman

OFFICERS
President:
Frederick A. Litwin
Vice-president:
George Frankl
Secretary/treasurer:
William Harry Giles

BANKERS
The Royal Bank of Canada

AUDITORS
Gladwell & Gaviller
Chartered Accountants,
Toronto

TRANSFER AGENTS
Canada Trust Company

LISTED
Toronto Stock Exchange

HEAD OFFICE
401 Bay Street, Toronto

To Our Shareholders:

Operations of our company for the six months ended December 31, 1968, are reviewed in this special report to shareholders. Following the change in control which occurred during the period, a vigorous policy of acquisition has been launched. Our year-end has therefore been changed from June 30 to December 31 in order to simplify the presentation of our financial statements so that in future we will be able to present an accurate and complete picture of all our operations.

Financial Review and Forecast

Our financial results for the six months under review do not yet reflect the basic and exciting changes which have been taking place in our company. This has been a period during which the foundations of a bright new future for Erie have been laid. The change of name of our company to Erie Diversified Industries Limited symbolized the management policies now being followed.

Sales for the period were $1,671,702. Operating income for the six months ending December 31, 1968 was $89,463. Nonrecurring costs of reorganization and acquisition amounting to $29,426 and provision for income taxes of $32,245 resulted in net earnings of $27,792.

Earnings figures were affected by the high level of nonrecurring expenses connected with the reorganization of our company.

A major reorganization of capital structure was undertaken during the period, and on January 7, 1969, the changes were given final approval at a Special Meeting of Shareholders. The changes are:

(1) Creation of a new Class A preferred stock, representing a three-for-one exchange with the former Class A shares. The new shares carry a non-cumulative preferred dividend of 20 cents per share, are fully participating and are non-voting. Authorized capital of this class has been increased to 450,000 shares (no par value).

(2) Reclassification of the former Class B common stock as common shares with no par value. This new stock was also exchanged on a three-for-one basis. Authorized capital of the class was increased to 300,000 shares.

Our operating structure was changed during the period, but in spite of this it is worth noting that fabrics and wood still provide a common denominator to all our divisions. There is even a direct involvement of our wood products at H. A. Ball & Sons. A separate Wood Products Division, continuing the former name of Erie Flooring & Wood Products, has been set up to carry on the company's business in the hardwood industry and, following the acquisition of Twilight Investments Limited in December, a new Fabric Division was formed. This company operates under the name of A & A Fabrics as an importer and distributor of textile fabrics.

Recently, further acquisitions have led to the setting up of two other divisions. H. A. Ball & Sons Limited, engaged in the sale and reconditioning of steel container drums for the process industries, forms the nucleus of our Containers Division, while Lanark Furniture Company, which manufactures and sells upholstered furniture, is the basis of our Furniture Division. Another acquisition, Stitsky's Textile Centre, has added a chain of four retail fabric stores to the Fabric Division.

Acquisitions already made are expected to increase our sales to the $8 million mark by the end of 1969. Earnings can also be expected to improve substantially during 1969 as full advantage is taken of the opportunities for integration of operations and as the burden of nonrecurring expenses is lessened.

Board of Directors

Since the end of the period under review, the Board of Directors of our company has gained a valued new member. He is Mr. J. O. McCutcheon, Professor and Chairman of Civil Engineering and Applied Mechanics at McGill University. Mr. McCutcheon is a member of several national committees on engineering research and development, and a director of several Canadian companies.

The death of Mr. Gabriel Gat, a senior officer of the company, in April of this year was a sad loss to his colleagues and to our company. He has been replaced by Mr. Robert Walker who was his assistant for 18 years.

The Future

Accomplishing all of these developments would have been impossible without the support of our employees, customers and business friends. We trust that this will continue at the same high level during the coming year.

We feel that we are operating in areas which will give us excellent growth, that we are in fact in industries that have a healthy future. Looking forward we see further expansion within the divisions, which combined with further acquisitions in the same and other fields, will provide the growth pattern we all wish to see.

On behalf of the Board of Directors,

Fred Litwin

Frederick A. Litwin
President

June 1, 1969

Erie Diversified Industries Limited

Company Philosophy

Erie Diversified is a holding company growing both by internal expansion resulting from integration of operations and by acquisition. The company's approach to acquisition policy is to seek out firms whose operations complement its existing organization. Erie does not seek diversification merely for the sake of diversifying. It deliberately plans its acquisitions to take maximum advantage of opportunities for integration. General policy of the company is formulated at the head office, including assessment, discussion and negotiation of acquisitions and the important job of correlating the activities of all sectors to maximize efficiency and profits.

The company is organized in four operating divisions — Wood Products, Fabric, Containers and Furniture. Each of these divisions has something to offer to the others. Each division operates under the direct control of its own general manager, who is responsible for day to day operations. Major financial considerations and broad general policy are handled within the guidelines set by the Board of Directors. A stock option plan for senior management and key employees offers attractive incentives for performance and contributes to the high morale and aggressiveness displayed by our staff.

Wood Products Division *(Erie Flooring)*

Major programs of expansion and modernization are making this thriving division one of the most efficient and competitive wood products operations in Canada.

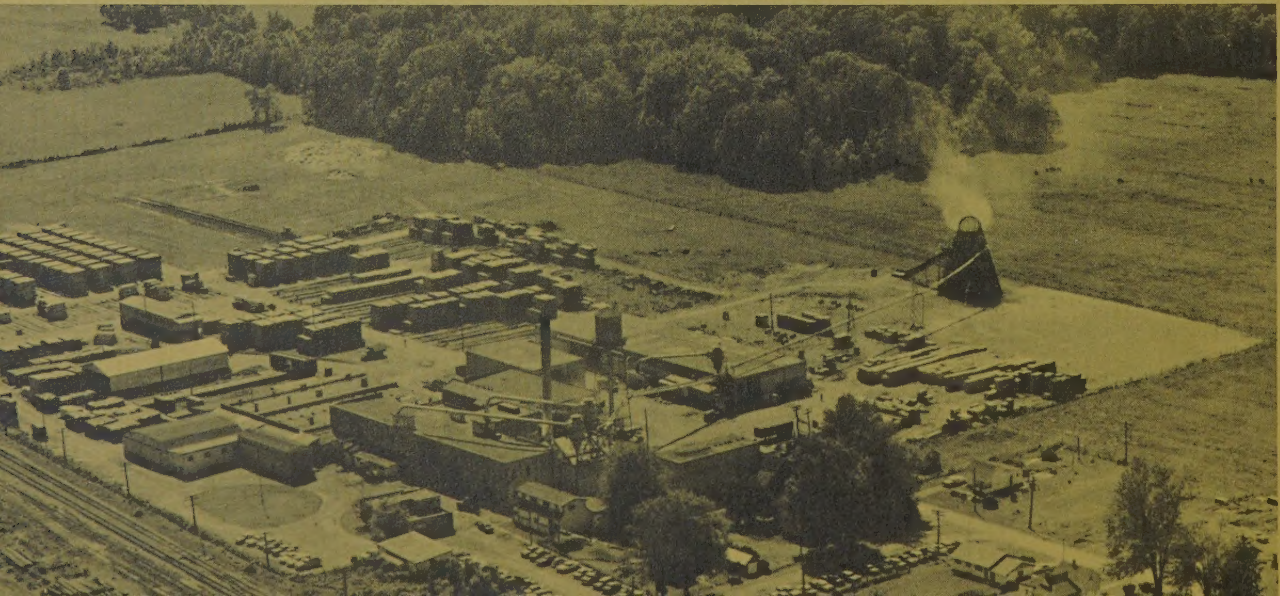
Strip and parquet flooring, pallets and semi-finished dimension stock are produced in its plant at West Lorne, Ontario, just one mile from the MacDonald-Cartier Freeway.

The division has been able to maintain its share of the strip flooring market, and is growing steadily because of the increasing demand for parquet flooring by the building industry. Erie is in a strong position to take profitable advantage of this trend. The modern automated production lines it has installed within the last two years produce parquet flooring by an advanced method in which the small sections which make up the flooring are held together by a web backing made from a form of cotton.

Growth in sales of this type of parquet flooring at a rate of between 10 per cent and 15 per cent a year is expected as the building boom continues and as more and more builders become accustomed to using it.

Currently parquet accounts for about 30 per cent of the division's sales at home and abroad.

Erie is also well equipped to win a major share of the rapidly expanding market for pallets. New machinery, which allows pre-drilling and nailing of pallets in a single production line, gives Erie an edge over its competitors in this field. Capacity use of this equipment will give Erie a commanding position in the Ontario market.



Furniture Division *(Lanark)*

Medium priced upholstered furniture is produced by this division in its Toronto facilities.

The division has achieved annual average sales growth of around 10 per cent a year in the 20 years it has been in business, and this rate can be expected to accelerate as demand increases.

Major factors affecting furniture sales include population growth, housing completions and personal disposable income. Current upward trends in all three of these suggest a continued rise in demand.

Most new homes today have more rooms to be furnished and as incomes rise the well-kept living room is becoming a centre of family entertainment and good living. Inevitably these trends imply more customers for good-quality furniture.

Erie Diversified regards Lanark as a strong base for further expansion in the furniture business. There are good possibilities for integration with other divisions of Erie. About half of the wholesale value of upholstered furniture consists of materials, principally wood and fabrics.

Lanark has built up a fine reputation for good-quality products. It has a strong sales staff and is in a good position to take profitable advantage of the exciting growth opportunities in the furniture business.

Containers Division *(H.A. Ball & Sons)*

This division is an old, well-established operation in a growth field — the cleaning and reconditioning of steel containers for the process industries.

It operates from a two and a half acre site on prime industrial land near to the Gardiner and Don Valley Expressways in downtown Toronto.

Metal drum containers are the main means of shipping bulk powders and liquids. Each container can be reconditioned as many as 15 times, so the reconditioning business is an extremely important factor to these basic industries.

To recondition containers, H. A. Ball uses various techniques such as burning, sand-blasting, caustic soda baths and spray-painting equipment.

Aggressive marketing under new and energetic young management is already attracting new business. The amount of business available is growing steadily as basic Canadian industry expands, but Erie also expects its containers division to increase its share of the market.

Expansion of operations, through acquisition and by installation of facilities for manufacturing new drums, offers attractive possibilities for additional growth of sales and earnings.

Fabric Division

Wholesale (A & A Fabrics)

This fast-growing and profitable operation has built up a fine reputation in the business of importing and distributing fabric and trim to retail stores and clothing manufacturers.

Independent U.S. studies show that home sewing is growing at rates of between 20 per cent and 30 per cent a year because of increased awareness of fashion allied with the constantly rising cost of labor. Better sewing machines, improved and simplified patterns and instructions also contribute to this record growth rate.

These factors all suggest a bright future for fabric and trim sales, and the skill and know-how of A & A's young aggressive management give the division a vital advantage in competing for a major share of this booming market. Strong expansion of A & A's sales, resulting both from general growth of the market and from displacement of competitors' business, is confidently expected.

Retail (Stitsky's Textile Centre)

Four retail fabric outlets are operated under the Stitsky name in Metro Toronto, providing 25,000 square feet of selling area. Expansion now under way at the largest of these stores will add another 15,000 square feet of selling area.

Fabric, accessories, trim, notions, draperies and patterns are all sold, and the strong growth of home sewing must inevitably lead to a rising trend in sales of all these products.

Expansion is planned for the shop-at-home service and of contract sales.

ERIE DIVERSIFIED INDUSTRIES LIMITED
(formerly Erie Flooring & Wood Products Limited)

CONSOLIDATED STATEMENT OF INCOME AND RETAINED INCOME
for the six months ended December 31, 1968

Revenue:	
Sales	$1,671,702
Expenses (income):	
Cost of sales (including depreciation of $24,985)	$1,475,113
Administrative and selling expenses	112,588
Interest on long-term debt	2,012
Dividend from associated company	(7,474)
	$1,582,239
Operating income for the period	$ 89,463
Reorganization and acquisition costs	29,426
Net income for the period before income taxes	$ 60,037
Estimated income taxes	32,245
Net income for the period	$ 27,792
Balance of retained income at July 1	884,966
Accumulated losses of a previously unconsolidated subsidiary	(17,418)
Dividends on Class A shares	(10,500)
Balance of retained income at December 31	$ 884,840

AUDITORS' REPORT

To the shareholders of Erie Diversified Industries Limited:

We have examined the consolidated balance sheet of Erie Diversified Industries Limited as at December 31, 1968 and the consolidated income and retained income and source and use of working capital statements for the six months then ended. Our examination of the financial statements of Erie Diversified Industries Limited and those subsidiaries of which we are the auditors included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances. We have relied on the report of the auditor who has examined the financial statements of Twilight Investments Limited.

In our opinion, these consolidated financial statements present fairly the financial position of the companies as at December 31, 1968 and the results of their operations and the source and use of their working capital for the six months then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year, except for the change in consolidation practice as explained in Note 3.

GLADWELL & GAVILLER
Chartered Accountants,

April 7, 1969. Toronto, Ontario

ERIE DIVERSIFIED INDUSTRIES LIMITED
(formerly Erie Flooring & Wood Products Limited)

CONSOLIDATED BALANCE SHEET as at December 31, 1968

ASSETS

CURRENT:		
Cash	$ 31,374	
Accounts receivable	518,797	
Advances on material purchase contracts	46,787	
Inventories (Note 4)	802,883	
Prepaid expenses	13,656	
		$1,413,497
INVESTMENTS, at cost:		
Deposit on option to purchase (Note 10)	$ 60,000	
Sundry	18,234	
		78,234
FIXED, at cost (Note 5):		
Land, buildings, machinery and equipment	$792,688	
Less — Accumulated depreciation	490,558	
		302,130
OTHER:		
Excess of cost of shares in subsidiary company over fair value of net assets acquired (Note 3)	$125,815	
Sundry	1,145	
		126,960
		$1,920,821

LIABILITIES

CURRENT:		
Bank indebtedness (Note 6)	$446,157	
Accounts payable and accrued liabilities	364,424	
Income and other taxes payable	65,400	
Current portion of long-term liability	20,000	
		$ 895,981
LONG-TERM:		
7% first mortgage payable to the Industrial Development Bank, due 1971	$ 50,000	
Less — Current portion	20,000	
		30,000
SHAREHOLDERS' EQUITY:		
Capital stock (Notes 7 and 10) —		
Authorized —		
35,000 Class A $0.60 cumulative non-voting non-redeemable preference shares, no par value		
100,000 common shares, no par value		
Issued —		
35,000 Class A	$ 14,737	
74,000 common	95,263	
	$110,000	
RETAINED INCOME	884,840	
		994,840
		$1,920,821

Approved on behalf of the board

F. A. LITWIN, Director

W. H. GILES, Director

The accompanying notes are an integral part of the consolidated financial statements.

ERIE DIVERSIFIED INDUSTRIES LIMITED
(formerly Erie Flooring & Wood Products Limited)

CONSOLIDATED STATEMENT OF SOURCE AND USE OF WORKING CAPITAL
for the six months ended December 31, 1968

Source of working capital:	
Operations —	
Net income	$ 27,792
Add — Expenses not requiring use of working capital —	
Depreciation	24,985
	$ 52,777
Sale of shares in associated company	41,727
Sale of fixed assets	5,884
Common stock issued	70,000
Working capital acquired from subsidiaries	67,726
Other	3,654
Total source	$ 241,768
Use of working capital:	
Deposit on option to purchase (Note 10)	$ 60,000
Purchase of fixed assets	56,861
Excess of cost of shares in subsidiary company over fair value of net assets acquired (Note 3)	125,815
Reduction in mortgage payable	10,000
Accumulated losses of a previously unconsolidated subsidiary (Note 3)	17,418
Dividend on Class A shares	10,500
Other	1,397
Total use	$ 281,991
(Decrease) in working capital	$ (40,223)
Working capital at July 1	557,739
Working capital at December 31	$ 517,516
Working capital:	
Current assets	$1,413,497
Current liabilities	895,981
Working capital at December 31	$ 517,516

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
as at December 31, 1968

1. CHANGE IN YEAR-END

   Because of a change in year-end to December 31, the financial statements are presented for a six-month period only.

2. COMPARATIVE STATEMENTS

   As the change in consolidation practice, referred to in Note 3, had no material effect on the financial statements of Erie Diversified Industries Limited (Erie) previously presented and because of the change in Erie's year-end and the difference in year-ends that existed among the parent and its subsidiaries at that time, the June 30, 1968 income statement has not been restated and is presented separately for comparative purposes.

3. ACQUISITION AND PRINCIPLES OF CONSOLIDATION

   On December 1, 1968 Erie acquired the outstanding shares of Twilight Investments Limited (Twilight) at a cost of $170,000 which was paid in cash ($100,000) and by issuing 14,000 (pre-split) Class B common shares which have been recorded at $5 each. The acquisition has been accounted for as a purchase, and the consolidated statement includes the operations of Twilight from December 1, 1968. The company does not intend to amortize the excess of cost of Twilight's shares over fair value of net assets acquired ($125,815).

As a result of the above transaction, Erie changed its policy on accounting for subsidiaries to include the accounts of its subsidiaries on the December 31, 1968 consolidated financial statements. Accordingly the consolidated financial statements include the accounts of the three subsidiary company (all wholly owned) as follows:

Esskay Floors Limited
Bopal Developments Limited
Twilight Investments Limited

In prior periods, the company's financial statements did not include the accounts of its subsidiaries since their assets and liabilities and operations were not significant in relation to Erie's, and their year-ends were six months removed from Erie's. The consolidated retained income of the company as at July 1, 1968 has been reduced to include losses of $17,418 since acquisition of a previously unconsolidated subsidiary.

4. INVENTORIES

Inventories comprise the following:

Finished products, manufactured or purchased	$331,434
Raw materials and supplies	471,449
	$802,883

Finished goods are valued at the lower of cost and net realizable value. Raw materials and supplies are valued at the lower of cost and replacement cost.

5. FIXED ASSETS

Fixed assets and accumulated depreciation are classified as follows:

	Cost	Accumulated Depreciation	Net
Land	$ 10,845	—	10,845
Buildings	150,988	54,416	96,572
Machinery and equipment	630,855	436,142	194,713
	$792,688	490,558	302,130

Depreciation has been calculated on the declining balance method at rates normally permitted for income tax purposes.

6. BANK INDEBTEDNESS

The parent company has pledged its accounts receivable ($448,093) as security for bank indebtedness amounting to $384,869.

7. CAPITAL

During the period the Class B shares were re-designated as no par value common shares, an additional 40,000 such common shares were authorized, and 14,000 were issued on the acquisition of Twilight.

8. REMUNERATION (directors and senior officers)

Remuneration of directors and senior officers amounted to $32,350.

9. CONTINGENT LIABILITY

One of the subsidiaries is contingently liable in the amount of $134,425 in respect of factored accounts receivable.

10. POST BALANCE SHEET EVENTS

A Capital:

On January 17, 1969 supplementary letters patent were issued —

(1) re-classifying the Class A preference shares into new Class A preference shares on a one-for-one basis, subdividing them on a three-for-one basis, each split share carrying the right to a non-cumulative $0.20 preferential dividend as well as being participating, non-voting and without par value,

(2) subdividing the common shares on a three-for-one basis,

(3) increasing the number of authorized Class A preference shares to 450,000,
(4) providing that the maximum consideration for which shares shall be issued is —

Authorized Capital	Amount
450,000 Class A preference shares	$5,000,000
300,000 common shares	1,000,000

(The new Class A preference shares are not redeemable.)

Subsequently shares were issued for cash by private placement as follows —

40,000 Class A preference shares for	$500,000
5,000 common shares for	100,000
	$600,000

B Stock option plan:
Of the authorized and unissued Class A preference and common shares, 5,250 Class A preference and 11,100 common shares (after the three-for-one split) are reserved under an executive and employee stock option plan entered into after December 31, 1968. Options granted under this plan are for terms up to ten years at ninety per cent of the market value of the date granted. Options on 4,350 Class A preference shares and 9,300 common shares at $10 per share have been granted.

C Acquisitions:
In February, 1969 the company acquired all the outstanding shares of H. A. Ball & Sons Limited (Ball) for $620,000 cash; a deposit of $60,000 on an option to purchase Ball had been made in 1968.

In March, 1969 the company incorporated a subsidiary company, Lanark Furniture (1969) Limited, to purchase the net assets of Lanark Furniture Company for $500,000 cash, and a $550,000 non-interest bearing debenture, maturing $450,000 in 1971 and $100,000 in 1974, and convertible into new Class A preference shares of Erie as follows:

1970	9,900 shares
1971	9,900 shares
1974	4,950 shares
	24,750 shares

The liability under the convertible debenture is subject to downward adjustment if a specified earnings level, under certain conditions, is not reached by Lanark (1969).
The debentures will be secured by assignment of a $500,000 note to be issued by Lanark (1969) to Erie, by Erie's investment in Lanark (1969) shares ($100) and a guarantee by Erie.

D Borrowing:
The parent company has borrowed $220,000 on a 6% promissory note, maturing in 1974 and collaterally secured by a first mortgage on the real estate of, and a chattel mortgage on the equipment of, Ball.

ERIE FLOORING AND WOOD PRODUCTS LIMITED

Although no valid comparison of the 1968 results of the present company — Erie Diversified — can be made with earlier results of Erie Flooring and Wood Products Limited, the income statement for the latter company for the year ending June 30, 1968, is presented here for the interest of shareholders.

Sales	$2,787,888
Cost of sales, including depreciation of $48,936	$2,471,190
Administrative and selling expenses	178,857
Interest on long-term debt	5,086
	$2,655,133
Operating income	$ 132,755
Dividend from associated company	5,830
Net income for the year before income taxes	$ 138,585
Estimated income taxes	60,000
Net income for the year	$ 78,585

ERIE DIVERSIFIED INDUSTRIES LIMITED
401 BAY STREET, SUITE 2106, TORONTO CANADA.